

Message Text

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ACTION ARA-20

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TAGS EFIN

SUBJ OPEN MARKET OPS IN COLOMBIA

REF BOGOTA 1017

1. BEGIN SUMMARY. OPEN MARKET OPERATIONOR THE SALE OF GOVT BONDS IN THE DOMESTIC MARKET CAN BE VIEWED AS A POTENTALLY SIGNIFICANT NEW GOVT INITIATIVE TO FIGHT INFLATION. THE BOND SALES, AT MARKET DETERMINED INTEREST RATES, CAN BE USEFUL TO: (A) HELP SOAK UP EXCESS LIQUIDITY RESULTING FROM PAST MONEY SUPPLY EXPANSIONS AND (B) LEAD THE WAY TOWARD A RATIONAL INTEREST RATE POLICY IN COLOMBIA TO BE GOVERNED MORE BY MARKET FORCES THAN GOVT REGULATION. THE FIRST TWO WEEKS OF OPEN MARKET OPS SUGGEST A MIXED PICTURE. ON THE POSITIVE SIDE NET PURCHASES HAVE EXCEEDED 200 MILLION PESOS. HOWEVER, THE GOC HAS DECIDED THAT, AT LEAST FOR THE PRESENT, THE BONDS WILL ALL BE SOLD AT PREDETERMINED FIXED DISCOUNT RATES. THE ESTABLISHED DISCOUNT RATE MAY BE ALLOWED TO VARY DEPENDING ON MARKET CONDITONS. BOND SALES SO FAR HAVE NOT SIGNED THE BEGINNING OF INTEREST RATE REFORM. IT IS UNCLEAR AT THIS TIME IF THE PASTRANA ADMIN WILL ALLOW INTEREST RATES ON FUTURE BOND ISSUES TO BE DETERMINED DIRECTLY BY MARKET FORCES. END SUMMARY.

2. ON MAY 21/74 THE BOR ISSUED CIRCULAR NBR 3.535 ESTABLISHING LIMITED OFFICIAL USE

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GUIDELINES ON OPEN MARKET OPS. THE BONDS BEING SOLD ARE CALLED TITULO

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DE PARTICIPATION AND HAVE A MATURITY OF THREE AND SIX MONTHS WITH EFFECTIVE YIELDS OF 19.5 AND 20.5 PERCENT RESPECTIVELY. THE BOR IS SELLING THEM AT A FIXED DISCOUNT AND REPURCHASING THEM AT FACE VALUE. THE BONDS MAY BE SOLD BACK TO THE BOR AT ANY TIME WITH A PENALTY WHICH REDUCES SOMEWHAT THE EFFECTIVE YIELD. ALL BONDS HAVE A FACE VALUE OF AT LEAST 100 THOUSAND PESOS. ISSUES WILL BE PLACED BY THE BOR ON THURSDAYS DIRECTLY TO INTERESTED BANKS AND FINANCIAL INSTITUTIONS. PROFITS TO BE DERIVED FROM BOND TRADING WILL BE SUBJECT TO INCOME AND CORPORATE TAXES. FINALLY BOND PURCHASES WILL NOT BE CONSIDERED BY THE MONETARY AUTHORITIES AS SUBJECT TO PRIOR BANK DEPOSIT LIMITATIONS.

3. IF THESE BONDS ARE TO BE EFFECTIVE IN THE MEDIUM TO LONG RUN IN ABSORBING EXCESS PESO LIQUIDITY THEY MUST BE ROLLED OVER OR REPURCHASED AND THEN RE-ISSUED. THE BOR IS LIKELY TO ROLL OVER THE ISSUES IF SUFFICIENT DEMAND IS GENERATED WHICH TO NO SMALL EXTENT WILL DEPEND ON THE EFFECTIVE INTEREST RATES. LONGER TERM BOND ISSUES ARE LIKELY TO BE INITIATED IF INITIAL ISSUES ARE FAVORABLY RECEIVED. THERE IS REASON TO BELIEVE THAT PESOS RECEIVED BY THE GOC THROUGH THE BOND SALES ARE LIKELY TO BE USED TO HELP FINANCE ANTICIPATED CENTRAL GOVT DEFICIT THIS YEAR.

4. BEGIN COMMENT. IT IS BELIEVED THAT GOC'S DECISION TO POSTPONE NORMAL MARKET INTEREST RATE DETERMINATION ON BOND ISSUES AT THIS TIME PROBABLY IS MOTIVATED BYNGEAR THAT A FREELY DETERMINED INTEREST RATE IN THIS CASE WOULD COMPETE WITH THE GOC OBJECTIVE OF ENCOURAGING INCREASED FINANCIAL SAVINGS THROUGH THE UPAC SYSTEM. ONLY UPACS PRESENTLY GUARANTEE SAVERS A REAL POSITIVE RATE OF RETURN. FURTHERMORE THERE ARE FORCES WITHIN THE PRESENT ADMIN WHICH HAVE ARGUED AGAINST MARKET DETERMINED INTEREST RATES BECAUSE OF THE POTENTIAL DETRIMENTAL AFFECTS IT MIGHT HAVE ON THE COST OF CREDIT TO DEVELOPMENT AGENCIES AND SMALL BUSINESSES. UNDER THE MOST PESSIMISTIC ASSUMPTIONS ONE CAN VIEW PRESENT ATTEMPTS AT OPEN MARKET OPS AS LAYING THE GROUND WORK FOR FULL FLEDGED OPS SOMETIME IN THE NEAR FUTURE. THE NEW ADMIN IS NOT LIKELY TO VIEWUPAC WITH THE SAME HIGH PRIORITY AND IS THEREFORE MORE LIKELY TO INITIATE INTEREST RATE REFORM AND REAL OPEN MARKET ACTIVITY. VAKY

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